

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-96 (1) R
Real Estate Transfer Tax
Real Property Transfer Gains Tax
January 30, 1996

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. M950911A

On September 11, 1995, a Petition for Advisory Opinion was received from Lew R. Wasserman, Jean Stein, Gerald H. Oppenheimer and Andrew Shiva, as Trustees of Annuity Trusts I & II under the Restatement of Doris Jones Stein Family Trust dated 4/20/82, P.O. Box 30, Beverly Hills, California 90213.

The issues raised by Petitioners, Lew R. Wasserman, Jean Stein, Gerald H. Oppenheimer and Andrew Shiva, as Trustees of Annuity Trusts I & II under the Restatement of Doris Jones Family Trust dated 4/20/82, are:

1. Is the combination of Annuity Trust I with Annuity Trust II, pursuant to which the New York Properties will be transferred to the Surviving Trust, including the execution of the Loan-Back Agreement, exempt from the Transfer Tax pursuant to Tax Law §1405(b)(6) and 20 NYCRR 575.10 as a mere change of identity or form of ownership or organization?
2. Is the combination of Annuity Trust I with Annuity Trust II, pursuant to which the New York Properties will be transferred to the Surviving Trust, including the execution of the Loan-Back Agreement, exempt from Gains Tax pursuant to Tax Law §1443(5) and 20 NYCRR 590.7, as a mere change of identity or form of ownership or organization?

Petitioner presents the following facts. On April 20, 1982, Doris Jones Stein (the "Trustor"), as trustor, created a revocable inter vivos trust, known as the Doris Jones Stein Family Trust (the "Family Trust"). The instrument establishing the Family Trust, as amended and restated on April 20, 1982, provides for the creation of two charitable lead trusts following the death of the Trustor. The two trusts are referred to separately as "Annuity Trust I" and "Annuity Trust II" and collectively as the "Trusts". The Trustor died on April 7, 1984, and Annuity Trust I and Annuity Trust II were thereafter established in accordance with the terms of the Family Trust instrument and under the jurisdiction of the Los Angeles County Superior Court.

Annuity Trust I and Annuity Trust II are each required to make certain annual charitable payments until their respective termination dates. At that time any remaining assets are to be distributed to trusts for the benefit of certain heirs of the Trustor or their appointees.

The remainder beneficiaries of Annuity Trust I and Annuity Trust II are trusts for the benefit of the Trustor's grandchildren (the "Grandchild Trusts") and more remote issue (the "Issue Trusts"). The Grandchild Trusts were established, and the Issue Trusts were provided for, at the date of the

Trustor's death according to the terms of the Family Trust instrument. There are now ten living grandchildren of the Trustor and none of the grandchildren have died. Since none of the Trustor's grandchildren have died leaving issue, no Issue Trust has been established.

The terms and provisions of Annuity Trust I and Annuity Trust II are substantially identical except that the Trusts pay different annual amounts to charity and have different termination dates. Annuity Trust I terminates on February 10, 2003 and Annuity Trust II terminates on April 7, 2012. The annual payments for the Trusts are required to be made to the Jules and Doris Stein Foundation (the "Foundation"), an organization exempt from Federal income tax pursuant to Section 501(c)(3) of the Internal Revenue Code.

The beneficiaries of Annuity Trust I and the beneficiaries of Annuity Trust II are currently identical. Births, deaths and the naming of appointees hereafter could change the identity of the beneficiaries of either Trust. However, it is anticipated that if the Trusts are combined, the beneficiaries of the Trusts will be identical at the time of the combination of the Trusts.

A substantial portion of the assets of Annuity Trust I and of Annuity Trust II consists of stocks and securities. In addition, Annuity Trust I and Annuity Trust II are co-owners of two parcels of real property located in New York City (the "New York Properties") in undivided one-third and two-thirds interests, respectively, as tenants-in-common. Recently, both the value and the rental income of the New York Properties have declined. Moreover, due to current economic conditions, the income of the Trusts from their portfolios of stocks and securities has been lower than was foreseen at the time of their creation. As a result of these developments, the Trusts' obligations to make annual contributions to the Foundation are substantially greater than their current income.

Due to the financial difficulties facing the Trusts, the trustees have agreed to combine the Trusts on the terms and subject to certain conditions as set forth in an Agreement to Combine Trusts (the "Agreement"), a Petition for Order Authorizing Combination of Trusts and Amending Trust Instrument to Effectuate Combination to be filed with the Los Angeles County Superior Court, and an Order Authorizing Combination of Trusts and Amending Trust Instrument to Effectuate Combination to be signed by the Los Angeles County Superior Court (the "Order").

The Agreement and the Order provide that, on the effective date specified in the Agreement (the "Effective Date"), Annuity Trust I will be combined with Annuity Trust II. The Surviving Trust will succeed to all of the assets and will assume all the liabilities of the Trusts existing on the Effective Date. The Surviving Trust will have an obligation to make annual distributions to the Foundation equal to the sum of obligations currently required of the Trusts. Prior to February 10, 2003 (the termination date of Annuity Trust I), the Surviving Trust will be required to annually distribute an amount to the Foundation equal to the total of the amount which would have been required to be distributed by the Trusts. After that date, the Surviving Trust will be required to distribute to the Foundation only the amount required to be distributed by Annuity Trust II.

The Family Trust provides that the trustees of Annuity Trust I and Annuity Trust II are to be the persons who serve from time to time as the directors of the Foundation. The combination of the Trusts will effect no change in the identity of the trustees. In addition, the trustees will have the same powers with respect to the Surviving Trust that they currently have with respect to the Trusts.

The Agreement and the Order provide a method for determining the amount and timing of any distribution to be made to the remainder beneficiaries of Annuity Trust I (the "Annuity Trust I Beneficiaries") from the Surviving Trust on February 10, 2003, or thereafter. That method is such that there will be established on the books of the Surviving Trust a financial record referred to in this Agreement as the "Pro Forma Account". The Pro Forma Account will be set up so that the remainder interests of the Annuity Trust Beneficiaries and the Foundation's right to distributions will not be affected by the combination of the Trusts.

The Pro Forma account will function as follows: all of the assets of Annuity Trust I and Annuity Trust II will be valued at their fair market value as of the Effective Date. The Pro Forma Account will be credited on the Effective Date with the then fair market value of the principal and current and accumulated income contribution to the Surviving Trust by Annuity Trust I, less the liabilities, if any, of Annuity Trust I (other than the liability to make annual payments to the Foundation). All liabilities of the Annuity Trust I on the Effective Date are to be assumed by the Surviving Trust. Thereafter, until February 10, 2003, the Pro Forma Account will be reduced by distributions when and as made to the Foundation by the Surviving Trust, but only up to the amount which would have been distributed by Annuity Trust I had Annuity Trust I remained in existence. Until February 10, 2003, the Pro Forma Account will be increased by an amount of the income of the Surviving Trust equal to the sums of (1) one-third of the gross income from the New York Properties when and as received by the Surviving Trust, plus (2) the remaining gross income of the Surviving Trust when and as received excluding gross income from the New York Properties, multiplied by a fraction, the numerator of which is the balance of the Pro Forma Account (excluding one-third of the value of the New York Properties) and the denominator of which is the value of the Surviving Trust (excluding the entire value of the New York Properties). Both the numerator and denominator of the fraction shall be determined as of the Effective Date. The Pro Forma Account will also be reduced by (3) one-third of the amount of the expenses of the New York Properties when and as paid, and (4) a portion of the Surviving Trust's expenses unrelated to the New York Properties when and as paid determined by multiplying these expenses by the same fraction as is used for allocating trust income other than income from the New York Properties under clause (2) above. In accordance with the Agreement, the computation of the Pro Forma Account will be made not less frequently than annually. Additionally, gross income will include capital gains and expense will include capital losses, these gains and losses to be determined by reference to the carrying value of the Surviving Trust's capital assets.

As of February 10, 2003, the balance of the Pro Forma Account as determined above will be further adjusted by (1) one-third of any previously unrecognized appreciation or depreciation in the New York Properties, (2) one-third of any accrued but unreceived or unpaid income or expenses with respect to the New York Properties, (3) the same fraction as provided in the preceding paragraph of

any previously unrecognized appreciation or depreciation in the Surviving Trust's assets other than the New York Properties, and (4) the same fraction of any accrued but unreceived or unpaid income or expenses with respect to assets other than the New York Properties. This determination will require an appraisal of the real property and other non-liquid assets of the Surviving Trust as of February 10, 2003. There will be a distribution to the Annuity Trust I Beneficiaries on February 10, 2003, or as soon as practicable thereafter, equal to the positive (but not negative) balance of the Pro Forma Account, but only if the trustees determine that the Surviving Trust will have sufficient liquid assets remaining after the distributions to continue to meet its obligations to the Foundation through the termination date of the Surviving Trust. This determination will be made by the trustees first valuing all of the assets of the Surviving Trust (including the New York Properties) as of February 10, 2003. This amount will be reduced by (1) the balance of the Pro Forma Account as of that date and (2) the value of any real estate and any other nonliquid assets of the Surviving Trust. The resulting balance, referred to in the Agreement as the "Net Value," will reflect the value of the available liquid assets of the Surviving Trust as of February 10, 2003. The trustees will then determine the present value of all future payments required to be made to the Foundation, using a discount rate equal to the average return on investment realized by the Surviving Trust over the immediately preceding five years. This amount will then be increased by 10%. The resulting amount, referred to in the Agreement as the "Discounted Payments", is intended to reflect the present value of the obligation of the Surviving Trust to the Foundation, with a 10% safety factor added. If the Net Value equals or exceeds the Discounted Payments, then a distribution equal to the positive balance of the Pro Forma Account will be made to the Annuity Trust I Beneficiaries on February 10, 2003, or as soon thereafter as practicable. If the Net Value is less than the Discounted Payments, then no distribution will be made as of February 10, 2003.

If the Net Value does not equal or exceed the Discounted Payments as of February 10, 2003, the Pro Forma Account will be credited with interest at the legal rate on judgments under California law, but shall not be increased or reduced by any income, expenses, gains or losses of the Surviving Trust accrued after February 10, 2003. The Annuity Trust Beneficiaries will receive notice of their respective interests in the Surviving Trust, if any, which will be their respective shares of the positive balance of the Pro Forma Account that would have been distributed to them on February 10, 2003, but for the fact that the Surviving Trust did not have sufficient liquid assets to meet its future obligations to the Foundation at that time. The Annuity Trust I Beneficiaries will be informed in writing that their interests in the part of the Surviving Trust represented by the Pro Forma Account are fully vested as of February 10, 2003, and are fully transferable.

If no distribution is made to the Annuity Trust I Beneficiaries as of February 10, 2003, the trustees of the Surviving Trust will make a similar computation to that described above as of December 31, 2004, and as of December 31st of each succeeding year until the Net Value equals or exceeds the Discounted Payments, so that a distribution equal to the Pro Forma Account may be made. If no distribution is made to the Annuity Trust I Beneficiaries prior to the termination of the

Surviving Trust, then upon termination of the Surviving Trust, the Annuity Trust I Beneficiaries will receive a distribution equal to the positive balance of the Pro Forma Account, if any, as of the date of termination and the Annuity Trust II beneficiaries will receive a distribution equal to the balance of the Surviving Trust.

The Family Trust, as amended and restated on April 20, 1982 (the "Restatement"), contains an in-kind distribution clause which grants the Trustees the discretion to make trust distributions in cash or in-kind or a combination of each. Since the Restatement is the governing instrument of both Annuity Trust I and Annuity Trust II, it would therefore be at the discretion of the Trustees of the Surviving Trust to make the distribution of the Pro Forma Account in 2003 to the various Grandchild Trusts which would be the remaindermen of Annuity Trust I had it remained in existence. In other words, those Trustees will have discretion whether the distribution is to be in cash, in-kind, or a combination of cash and in-kind. Presumably, those Trustees will take into account the economic conditions at the time of distribution, the projections for the future, possible tax consequences, etc. when making the determination as to the nature of the assets which are to be distributed.

In all events, the total value of the assets to be distributed in satisfaction of the Pro Forma Account in 2003 will be equal in value to the value of the assets which would have been distributed in 2003 had the combination under the Agreement to Combine not occurred and had Annuity Trust I remained in existence. The assets actually distributed will be referred to as the "Distributed Assets"

Given current projections, it seems likely that there will be little, if any, cash or other liquid assets available for distribution to the remaindermen in 2003. If there are more cash and liquid assets than projected, it also seems possible that any of the cash or other liquid assets would be retained by the Trustees of the Surviving Trust in order to provide funds to service future payments by the Surviving Trust to the Foundation. Therefore, it is assumed that all or a major part of the Distributed Assets, if any, will consist of an undivided interest in the New York Properties (recognizing that the possibility that future economic events might reduce the Pro Forma Account balance to zero).

Following the distribution in 2003, if any, there may (and most likely will) be a need for the Surviving Trust to borrow back some or all of the Distributed Assets in order to provide sufficient cash flow to meet the remaining annuity trust obligations to the Foundation. The distributees of the Distributed Assets (the Trustees of the Grandchild Trusts) have agreed at this time to lend back from the Distributed Assets in 2003 an amount, having a type and value reasonably required by the Trustees of the Surviving Trust, as will enable the Surviving Trust to complete its obligations to the Foundation without the need to distribute undivided interests in the New York Properties. The loan-back will be accomplished pursuant to the terms of a Loan-Back Agreement which will be executed at this time by the Trustees of the Grandchild Trusts.

To the extent liquid assets are not available in 2003, the Trustees of the Surviving Trust would deed interests in the New York Properties to the Trustees of the Grandchild Trusts at that time. If the loan-back of all or any part of the interests is required by the Trustees of the Surviving Trust pursuant to the Loan-Back Agreement, the Trustees of the Grandchild Trusts will execute deeds in favor of the Trustees of the Surviving Trusts, which will be recorded immediately following recordation of the deeds from the Trustees of the Surviving Trust to the Trustees of the Grandchild Trusts. The Trustees of the Grandchild Trusts would jointly execute a Distributee's Receipt and Loan-Back Agreement by which (1) the trustees of the Grandchild Trusts acknowledge the distribution and loan-back of the real property, and (2) the Trustees of the Surviving Trust would acknowledge the loan-back and value of the real property being lent to the Surviving Trust. A pro forma account for the assets which have been loaned back ("Extended Pro Forma Account") will be maintained in the same manner as the Pro Forma Account prior to 2003. The Loan-Back Agreement prescribes a valuation method for the assets to be loaned back.

The Loan-Back Agreement allows the Trustees of the Surviving Trust to repay the loan in whole or in part at the time or times when the conditions in the Agreement to Combine are met and the Extended Pro Forma Account can be distributed to the Grandchild Trusts possessing a vested interest in the loan-back, in accordance with the Agreement to Combine.

In summary, the mechanics of the loan-back will be (1) an actual distribution to the Grandchild Trusts of all assets in 2003 which are reflected in the Pro Forma Account (if positive); (2) a loan-back of assets to the extent required by the Trustees of the Surviving Trust; and (3) the Grandchild Trusts (and their respective beneficiaries to the extent the beneficiaries' interest) will be treated as the owners of the Distributed Assets (including the assets that are loaned back) for legal and tax purposes.

Discussion

Section 1402 of Article 31 of the Tax Law, imposes the real estate transfer tax on each conveyance of real property or interest therein when the consideration for the conveyance exceeds five hundred dollars.

Section 1401(e) of the Tax Law provides, in pertinent part, that the term "conveyance" means the transfer or transfers of any interest in real property by any method. This would include a conveyance upon the combination of trusts with an interest in real property.

Section 1405 of the Tax Law provides, in part, as follows:

Sec. 1405. Exemptions. -- (a) The following shall be exempt from payment of the real estate transfer tax:

* * *

6. Conveyances to effectuate a mere change of identity or form of ownership or organization where there is no change in beneficial ownership, other than conveyances to a cooperative housing corporation of the real property comprising the cooperative dwelling or dwellings;

In addition, pursuant to Sections 1441 and 1443.1 of the Tax Law, a tax is imposed on gains derived from the transfer of real property or an interest therein (the gains tax) where the real property is located in New York State and where the consideration for the transfer is \$1 million or more.

Section 1440.7 of the Tax Law defines the term "transfer of real property", in part, to mean the transfer or transfers of any interest in real property by any method. This would include a transfer upon combination of trusts with an interest in real property.

Also, Section 1443 of the Tax Law provides, in part, as follows:

Sec. 1443. Exemptions. -- A total or partial exemption shall be allowed in the following cases:

* * *

5. If a transfer of real property, however effected, consists of a mere change of identity or form of ownership or organization, where there is no change in beneficial interest.

In Hilles Timpson, Adv Op Comm T&F, November 3, 1992, TSB-A-92(7)R, the Commissioner held that the transfer of real property to a revocable grantor trust was exempt from the transfer tax and the gains tax pursuant to the exemptions provided at Sections 1405(a)(6) and 1443.5 (the mere change exemption) respectively.

In this case, the beneficiaries of Annuity Trust I and Annuity Trust II are currently identical, and following the combination will remain the same along with their respective interests. In addition, immediately after the combination of the Trusts, the charitable annuitant will have the same rights to distributions that it had prior to the combination. Likewise, the remainder beneficiaries of the Trusts, will be entitled to the same portion of corpus to which they were entitled before the combination. Annuity Trust II will terminate upon the same date as before the combination, and the Annuity Trust I Beneficiaries will be entitled to a distribution, or they will have a vested interest in a future distribution, on the same date that Annuity Trust I would have terminated had the combination not occurred.

With respect to issue no. 1, since the beneficiaries of the Trusts will remain the same and will have the same beneficial interest in the Surviving Trust as they held in the Trusts prior to their combination and the charitable annuitant will have the same rights to distribution that it had before the combination, there is no change in the beneficial ownership of the real property as a result of the conveyance. Accordingly, the combination of the Trusts results in a conveyance which is exempt from the transfer tax pursuant to the exemption provided at Section 1405(b)(6) (the mere change exemption).

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With respect to issue no. 2, the transfer of real property resulting from the combination of the Trusts is exempt from the gains tax pursuant to the exemption provided at Section 1443.5 of the Tax Law for the same reasons.

The execution of the Loan-Back Agreement does not affect the availability of the exemptions.

DATED: January 30, 1996

/s/
DORIS S. BAUMAN
Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.